



# Guiding Acquisitions and Investment Policy

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## THE TRADITIONAL APPROACH TO ACQUISITIONS

The sizeable sums involved in acquisitions, and the dire implications they have on a company's future, demand that these decisions are in the hands of the senior team running the organisation. The chairman plays a leading role, assuming a high level of responsibility for directional changes, group growth and corporate strategy.

A decision by a company to expand through acquisition usually takes it into discussions with its merchant bank who search for candidates. A portfolio of financial and background information is assembled on each acquisition to guide the deliberations. Visits by senior directors of the suitor company take place to look over the works and gain a view of the effectiveness with which the company is managed. Through the shrewd experience of the acquisition team, a decision is made as to whether the company would be suitable and a bid is proffered.

The weakness of this traditional approach to acquisition strategy is the relatively small emphasis given to the company's market position. The production resources are there to touch and observe; the finances are documented and can be plotted and analysed. Customer lists are sometimes made available if the acquisition believes that to do so will help the sale.

Nevertheless, the possibility of the deal not going through makes management at the acquisition company understandably taciturn about too high a level of disclosure. This means that acquisitions usually proceed with little knowledge of the customers, the marketing philosophy and the company's standing in the market. Acquisitions are made with only a cursory understanding of the company's market strengths and weaknesses and yet it is these, which have most influence on its future. Outdated machinery can be replaced, new sources of finance can be found but a bad image, a narrow customer base or a poor distribution network can take a long time and much management effort to rectify.

## THE ROLE OF MARKET RESEARCH IN ACQUISITION STUDIES

Market research has three roles to play in acquisition studies:

1. Identifying areas of opportunity and companies within them
2. Screening potential acquisitions
3. In-depth studies of nominated acquisitions

In the first of these capacities, market researchers require some limits within which to work. These may be geographical, products or industries. A fine balance must take place between a brief that is too wide and, therefore, in danger of spreading the research effort too thinly, and one that is too narrow, in which case the researchers are harnessed, perhaps at the expense of finding opportunities on wider horizons.

In general, however, the tighter brief proves the easier to handle. A more fruitful result can be expected from a brief that requires the researchers 'to examine the opportunities in engineering companies servicing US petrochemical installations' than one which says 'to examine the opportunities in industrial servicing in the US'. The latter gives the researcher some direction but not enough. The subject of his studies would in this case encompass services as wide apart as catering and consultancy. If an engineering company seeks an acquisition in a business where it has some understanding, it is unlikely to be interested in industrial catering. Even within the narrower definition which specifies the engineering industry, the scope for the researchers would be wide, involving leak sealing, valve lapping, fire protection, pipe installation, etc. The search for opportunities may produce acquisitions with high market shares, strong management teams, good growth and profit prospects or new products. Because the term 'opportunity' within the brief is broad, it may be advisable to



narrow the definition down to just one of these favourable conditions. In this way a screen is applied which eliminates all companies which do not meet the acquisition profile.

Shortlisting acquisitions by screening is made difficult if the screening factor needs detailed or privileged knowledge. If, for example, the screening factor were to eliminate all companies with a lawsuit against them, it would occupy the researchers in considerable work. Although potential acquisitions facing lawsuits are risks that should be avoided, such detail can be picked up at an early stage in the depth investigations.

Screens that are often applied by researchers in acquisition studies are:

- Product: eliminate all companies which do not sell a specified product
- User industries: eliminate all companies which do not sell to specified markets
- Market share: eliminate all companies with a market share below a certain figure
- Ultimate market potential: eliminate all companies operating in a sector with a ceiling on sales of £x million
- Growth prospects: eliminate all companies with growth prospects below x% over five years
- Size: eliminate all companies over/under a certain size (measured by number of employees or turnover)
- Exports: eliminate all companies that have an export content of more/less than x%
- Profitability: eliminate all companies which have a return on capital employed of less than x% over the last three years
- Location: eliminate all companies that fall outside a defined geographical area.

The importance of these screening criteria will vary depending on the ambitions of the suitor and the market in question. An established supplier of green sand castings may want to acquire a company with a similar product group to close it down and fill his own works with the order book. A cash-rich conglomerate may seek an acquisition to take it into high technology, and their interest is in a company with unique products and growth prospects rather than one that is currently large and profitable.

The screens can be applied at different times. A coarse screen at an early stage may eliminate those companies where information is obvious and easily available – they produce the wrong products; are located in the wrong geographical location; they are the wrong size. A secondary screen can then be applied more discriminatingly, so reducing the high research costs involved in studying market shares, growth prospects and strengths in user industries.

The final, and possibly the most important, contribution market research can make in acquisition studies is the depth study of the company. When a quoted company is to be studied, special precautions are necessary to preserve secrecy that, if lost, could lead to speculation in the share price. A code name for the company is almost always assumed. The acquisition of private companies is in many respects easier for the researcher as it usually takes place with cooperation from the firm which speeds up and allows a more thorough appraisal of customers and markets.

Where access to the acquisition is not directly possible, there will be restrictions on the depth of data which can be obtained on the company. Nevertheless, by piecing together information gained from discussions with other suppliers, distributors, customers and desk sources it is almost always possible to provide sufficient information to guide the acquisition team. The most critical restriction is invariably the time available to collect the data.

Information that is sought as background to the acquisition and its internal management can be summarised:

### **History of information**

This helps in understanding the position of the company today; it provides a benchmark and a perspective.



### **Product range**

Of obvious importance, especially the unique/special features, its modernity, breadth of range, prices, discounts, delivery, competitive position

### **Sales turnover**

By volume and value for as long a period as possible to show trends and provide a pointer as to the future. As much detail as possible is required on sales including breakdown by export territories, by salesmen's regions, by product groups.

### **End-user markets**

This will indicate the spread of the company, its vulnerability to recession or opportunities for growth.

### **Customer analysis**

Especially a listing of the top customers (say top 50) together with their turnover as an indication of the dependence on a few key accounts.

### **Financial performance**

Five years' accounts is usually sufficient, paying close attention to key ratios such as sales margins, return on capital, acid ratio, stock turn.

### **Management structure and employment**

A tree for the whole company (with ages of the managers) will help show the strength of first and second line management.

### **Marketing organisation**

The distribution network and description of the sales force shows the strength of the company's sales operation. Included here should be a description of its promotional budget and philosophy.

### **Licence/technical links**

These can be indicative of a valuable asset or, in some cases, reflect low R&D/innovative resources.

### **Production resources**

Market researchers should not attempt to report beyond the limits of their knowledge but they may usefully be able to provide a catalogue of key plant, show where the products are made, list chief suppliers of raw materials, describe important features of the production process, and estimate production capacity against output.

Besides the information on the internals of the acquisition itself, data must be collected on the market to provide an industry perspective and customers'/potential customers' views of the company:

### **Market size**

With this measure the researcher can see the ultimate potential for the company.

### **Market segmentation**

By breaking the market size down into product groups and end-user sectors, it is possible to show the performance of the company in narrower but possibly more meaningful niches.

### **Market shares**

The size of the acquisition is set against its competitors to show relative positions. The movement of market shares over time indicates winners and losers.

### **Growth prospects**

Trends in the market are an indicator of the prospects facing the acquisition.



## **Image**

Often neglected, this measurement should figure high in determining whether the acquisition goes ahead, as a good image compensates for many other deficiencies while a poor image is very difficult to repair.

The researcher may be asked to carry out an acquisition study starting from the first stage of building lists of possible companies of interest to the second stage of screening and finally to a depth study of any one of them.

A reporting break between each stage is normally built in to allow the finding to be digested and the objectives modified where necessary. Each stage of the report should contain a conclusions section with recommendations for action. At the end of stages one and two the conclusions may simply summarise the companies worthy of further consideration while the final stage would include recommendations to proceed (or not) with the acquisition, the need for any corrective action of the company and the opportunities it faces for short- and long-term expansion.

## **RESEARCH TO GUIDE INVESTMENT**

As an alternative to acquisition, a company may decide to expand by means of some other investment route. This could be:

### **Expansion of existing plant capacity**

Here the researcher produces a study to establish if the market can accommodate the extra capacity by natural growth or if it must be attained by stealing share from a competitor. Of course, most firms can flex their production departments and temporarily stretch themselves to meet a peak in demand. Longer-term expansion programmes, however, present the opportunity to build up production resources well beyond current order levels, and so marketing information becomes necessary to show the sales which can be achieved and sustained over a future period.

### **Green field Venture**

A company may decide to set up its own firm to distribute or manufacture goods rather than acquire a going concern. Because the company is starting with a 'green field', the production process and technical know-how can be bought in or developed internally. The market researcher is employed to show how quickly such an undertaking could obtain business, how the sales will build up over a period and the way in which sales will be achieved. Because a green field venture involves launching a company into a new market (for it), there is likely to be more uncertainty of success than in an acquisition or an expansion programme. Market research becomes all the more necessary because of the high risk and the large sums of capital that are involved.

Investment in a company normally increases efficiency or the capacity to supply more products or services. Research to indicate if the investment is viable should, therefore, be designed to show if and how sales can be increased by the required amount. Investment market research studies focus on:

- Market size - Is it big enough now or in the future to accommodate the proposed expansion?
- Competition - What are their strengths and weaknesses; which companies will be the most formidable competitors to the new or expanded company?
- The buying decision - How can buyers be switched to buying from the new/expanded company rather than traditional suppliers; which potential customers are likely to show the most rapid rate of increase in the future and how accessible are they?

## TECHNOLOGY TRANSFER

A company can aim to short circuit the technical development time required for a new venture by taking on a licence or buying outright the manufacturing rights to a product. Specialist companies offer data banks or use their connection to marry companies which have technology to offer and those which want to acquire it. The advantage of using these specialist technology transfer brokers is their speed and 'relatively' low cost. They can, however, suffer from out-of-date data banks full of producers or brochures which have been listed for six months and which nobody wants.

The market researcher can play a role in technology transfer by systematically screening the market for either a potential licensee or licensor. He must, however, have a number of guidelines from his board of directors, otherwise his study could spin off in wasteful directions. Say, for example, a company wants to find an electronic product to manufacture: the researcher would need to know in advance of designing the study:

1. Some parameters about the technical complexity of the product which is being sought. Should it be a simple product consisting of a few components and capable of assembly by a semiskilled work-force or should it need highly skilled electronic engineers?
2. Whether the product being sought should be a finished assembly or whether a sub-component would be acceptable.
3. Whether the product should hold a unique position in any market into which it is sold.
4. Some indication of the scale of business which it is hoped to build up. Is the company hoping for a modest sized business with sales of between £1 and £5 million per annum or is it looking ultimately for a much larger turnover?
5. Some indication of the markets it wishes to sell to. Is the company looking for a product which it can sell world-wide or will it accept restrictions on the countries available to it?

Even with these guidelines, the scope of a study to find a suitable electronic product would be very wide and, for this reason, may have only a limited likelihood of success. The larger the number of guidelines, the tighter the brief, and the more constraining the study is, but equally, the greater the chance of finding a suitable produce. The project would be carried out in stages with reviews at the end of each.

### Stage 1

A list of products is built up for consideration as being of possible interest to the prospective licensee. Against each product it is necessary to provide a description of its function and use, key aspects of its assembly, selling price, the method of selling and approximate market size. Broad answers are good enough at this stage, as succinct information is sufficient to enable a review committee to decide if a product looks interesting and is worth purchasing.

### Stage 2

After cutting back the list of products to a manageable number (perhaps between five and ten), more detailed information is collected to show a precise market size, the shares of the competition, buyers' attitudes to the different products etc: all the components of an orthodox survey except that much more emphasis will be given to building up profiles on companies that could be approached with a view to technology transfer. Data would be collected on the names of executives who deal with such matters, whether licensing deals exist with other companies and, if so, the nature of them.

### Stage 3

Finally, an approach is made to those companies from which a technology transfer is sought. Because the implications of a technology transfer are likely to be of great importance to both companies, contact is usually by senior executives at board level.



Technology transfer studies are usually very costly and it can take three to six months to carry out all the stages. The first two stages of the project comprise, in fact, a number of surveys or products and may well involve the researchers in overseas travel in their search for data on potential licensors.

## SUMMARY

Acquisitions are traditionally vetted by a high-powered team of senior manager who make their decisions after assessing the production and financial resources of the company under consideration. The marketing resources of acquisitions are less tangible and yet any weaknesses here can only be rectified over long term and at great expense.

Market research has three roles to play in acquisition studies. It can identify areas of opportunity and companies within them; it can be used to screen lists of potential acquisitions; finally, and most importantly, it can be used to produce a profile of potential acquisitions. Depth studies of acquisitions should provide a detailed background on the company's history, sales and customers. To put these into context, it should also position the company in the market as a whole.

Market research that guides investments is needed to show if and how the extra sales capacity can be sold. Investment is likely to fund an expansion of existing plant or a new venture. New ventures are especially risky and require market research to show if entry can be achieved and with what ultimate success.

Market research provides a logical and thorough means of identifying technological opportunities. In spite of its being time-consuming and expensive, it provides a faster and more secure means of diversification.



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